

NOT FOR PUBLICATION

**UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE TENTH CIRCUIT**

IN RE WILLIAM R. BARTMANN and
KATHRYN A. BARTMANN,

Debtors.

BAP No. NO-03-078

WILLIAM R. BARTMANN and
KATHRYN A. BARTMANN,

Appellants,

v.

COMMERCIAL FINANCIAL
SERVICES, INC.,

Appellee.

Bankr. No. 03-04975-R
Chapter 7

ORDER AND JUDGMENT*

Appeal from the United States Bankruptcy Court
for the Northern District of Oklahoma

Before McFEELEY, Chief Judge, BROWN, and CAMPBELL,¹ Bankruptcy
Judges.

McFEELEY, Chief Judge.

After examining the briefs and appellate record, the Court has determined unanimously that oral argument would not materially assist in the determination of this appeal. Pursuant to the Order entered on March 17, 2004, this Court grants the Appellants' request for a decision on the briefs without oral argument.

* This order and judgment is not binding precedent, except under the doctrines of law of the case, res judicata, and collateral estoppel. 10th Cir. BAP L.R. 8018-6(a).

¹ Honorable A. Bruce Campbell, United States Bankruptcy Judge, United States Bankruptcy Court for the District of Colorado, sitting by designation.

Fed. R. Bankr. P. 8012. The case is therefore submitted without oral argument.

Appellants/Debtors William R. Bartmann and Kathryn A. Bartmann (hereinafter when referred to collectively, “the Bartmanns”) appeal a judgment of the bankruptcy court for the Northern District of Oklahoma that converted their Chapter 11 case to one under Chapter 7. The Bartmanns argue that the bankruptcy court abused its discretion because the evidence supported the appointment of a Chapter 11 trustee but did not support the conversion of the case. We find no abuse of discretion and affirm.

I. Background

On December 11 1998, Commercial Financial Services (“CFS”) filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. William R. Bartmann (“William”) and Kathryn A. Bartmann (“Kathryn”) were two of the three founders of CFS. On January 11, 1999, CFS commenced an adversary proceeding against each of the Bartmanns.

The adversary proceeding was tried on June 2, 2003. The bankruptcy court found for CFS and entered a judgment against William in the amount of \$18,082,617.47 and against Kathryn in the amount of \$2,629,070.02 (“Judgments”). The Bartmanns appealed their respective Judgments to the United States District Court for the Northern District of Oklahoma.

Following the entry of the Judgments, CFS filed a motion with the bankruptcy court seeking to question the Bartmanns about their assets. The bankruptcy court granted this motion on August 11, 2003 and in two separate orders, ordered the Bartmanns to appear and answer on August 27, 2003 (Asset Hearing Orders”). Both Asset Hearing Orders included the following language:

YOU ARE FURTHER ORDERED to show cause why you should not be required to pay the judgment herein in installments in the event the Court may order you to do so; and YOU ARE ORDERED NOT TO PAY OUT, TRANSFER, MORTGAGE, ALIENATE, ENCUMBER OR MAKE ANY OTHER DISPOSITION OF MONEY, PROPERTY OR ASSETS EITHER REAL OR PERSONAL, NOT EXEMPT BY LAW, UNTIL FURTHER ORDER OF THIS COURT,

except for the reasonable and necessary support of self and family. Asset Hearing Order, *in Appellee's Supp. App.*, Vol. II at 474 (emphasis in the original).

Kathryn appeared on August 27, 2003, for the asset hearing and the examination began, but before the conclusion of the asset hearing, the Bartmanns' counsel announced that the Bartmanns had filed a voluntary joint Chapter 11 case. The asset hearing was stopped, and William was never examined.

On August 28, 2003, CFS filed in this case two proofs of claim based on its Judgments in the CFS bankruptcy case. On September 5, 2003, CFS filed in the Bartmanns' case a "Motion for the Appointment of a Chapter 11 Trustee or, Alternatively, to Convert Case to Chapter 7" ("Motion").

On September 17, 2003, the bankruptcy court held a hearing on the Motion. The following day, on September 18, 2003, the bankruptcy court ruled orally, finding that "CFS demonstrated ample cause to require a trustee to assume control of the property of the estate under both Sections 1104 and 1112" Transcript of Ruling, *in Appellee's Supp. App.*, Vol I at 291. The bankruptcy court cited the following findings to support its conclusion:

1. Clear and convincing evidence established that Kathryn had engaged in multiple financial transactions with her children, at least one of which occurred within the preference period. It was unrealistic to expect Kathryn, as the debtor-in-possession, to be a disinterested prosecutor or investigator of preference transactions between herself and her children. *Id.* at 292-93.

2. The Bartmanns engaged in other transactions with affiliated entities that deserved scrutiny by a disinterested fiduciary. *Id.* at 293.

3. Clear and convincing evidence established that the day before the Bartmanns filed their Chapter 11 petition, Kathryn withdrew \$9,000 in cash from at least three bank accounts. In addition, the Bartmanns wrote checks to pay selected creditors a total amount of \$33,000. These transactions violated the

injunction forbidding transfer or other disposition of property. *Id.* at 293-94.

4. On August 25 and 26, the Bartmanns transferred \$28,000 to their bankruptcy counsel despite the injunction forbidding the transfer of money or property of the Bartmanns. Their bankruptcy counsel never filed a request to represent the Bartmanns. *Id.* at 294.

5. None of the above-mentioned transfers were disclosed by the Bartmanns in their Statement of Financial Affairs. The original schedules signed by the Bartmanns were “rife with errors and omissions.” Although some of the errors were corrected by amended schedules, the Bartmanns did not reveal a tax refund claim of two million dollars and the federal government’s lien on that claim. They also did not disclose the various entities that were codebtors with them or that their former counsel had a lien on many of their assets. *Id.* at 295-96.

6. The Bartmanns did not immediately close their prepetition bank accounts and open a debtor-in-possession account, which resulted in post petition payment of prepetition debt that had to be recovered for the estate. *Id.* at 295.

7. Several Chapter 11 procedures were not observed, such as: (a) the Bartmanns used credit cards without court authority pursuant to § 364; (b) the Bartmanns liquidated the cash value of an insurance policy without court authority pursuant to § 363. *Id.* at 296-97.

The bankruptcy court concluded that the Bartmanns were not careful or reliable fiduciaries of the estate. *Id.* at 297. It determined that conversion rather than the appointment of a Chapter 11 trustee was the more appropriate remedy because the estate was “hopelessly administratively insolvent” with no projected income and that maintaining the case in a Chapter 11 would only result in further diminution of the estate. *Id.* at 297-301. It based this determination on the following factors:

A. Neither of the Bartmanns were employed and for the previous two years had no income from employment or business operations. *Id.* at 297.

B. The Bartmanns' initial report projected no income over the next four months but projected personal living expenses of approximately \$32,000. *Id.*

C. Over the six to eight weeks following the hearing, William would be engaged in defending himself against criminal charges and would be unlikely to generate income. *Id.*

D. The only evidence presented by the Bartmanns in support of a potential reorganization was the testimony that the Bartmanns had an expectation of drawing profits from a Westwood Stable business in which they had an interest of over 90%. However, the Bartmanns presented “[n]o financial statements, financial projections, business plans, or objective evidence of any kind . . . to support [the testimony] . . . or that such income would be sufficient to pay even the administrative expenses of a Chapter 11 proceeding.” *Id.* at 298. More importantly, Westwood Stables and another entity in which the Bartmanns had an interest, Neighborhood Financial Centers, were not in bankruptcy and their businesses were not assets of the estate. *Id.* at 298-99.

E. Although the Bartmanns contended that they might be successful in their appeal of CFS's 20 million dollar judgment, they did not post a supersedeas bond to obtain a stay of execution on their assets. *Id.* at 300.

F. The Bartmanns offered no adequate protection to CFS and there was no new money coming into the estate to substitute for their expenditures of approximately \$8,000 a month in personal living expenses. *Id.*

The bankruptcy court entered an order converting the case to one under Chapter 7.

This appeal timely followed.

II. Appellate Jurisdiction

The Bankruptcy Appellate Panel has jurisdiction over this appeal. An order converting a Chapter 11 case to one under Chapter 7 is a final order. *In re Vista Food U.S.A., Inc.*, 202 B.R. 499, 500 (10th Cir. BAP 1996). Appellants timely

filed a notice of appeal. The parties have consented to this Court's jurisdiction because they did not elect to have this appeal heard by the United States District Court for the Northern District of Oklahoma. 28 U.S.C. § 158(c)(1); Fed. R. Bankr. P. 8001; 10th Cir. BAP L.R. 8001-1.

III. Standard of Review

“For purposes of standard of review, decisions by judges are traditionally divided into three categories, denominated questions of law (reviewable *de novo*), questions of fact (reviewable for clear error), and matters of discretion (reviewable for ‘abuse of discretion’). *Pierce v. Underwood*, 487 U.S. 552, 558 (1988); *see* Fed. R. Bankr. P. 8013.

This Court will not disturb a bankruptcy court's findings of fact unless they are clearly erroneous. A factual finding is clearly erroneous when, although there is evidence to support it, upon examination of the entire evidence, the reviewing court is left with the definite and firm conviction that a mistake has been committed. *Anderson v. City of Bessemer City*, 470 U.S. 564, 573 (1985). This Court reviews a bankruptcy court's conclusions of law *de novo*. *Hall v. Vance*, 887 F.2d 1041, 1043 (10th Cir. 1989).

Whether a bankruptcy court properly converted or dismissed a case is reviewed for abuse of discretion. *Id.* at 1044. A bankruptcy court will have abused its discretion if its decision is “arbitrary, capricious, whimsical or manifestly unreasonable.” *United States v. Robinson*, 39 F.3d 1115, 1116 (10th Cir.1994) (quotations omitted).

IV. Discussion

The bankruptcy court determined that there was either cause to appoint a Chapter 11 trustee under 11 U.S.C. § 1104² or cause to convert the Bartmanns'

² Unless otherwise noted, all future statutory references are to title 11 of the United States Code.

case to one under Chapter 7 under § 1112(b). The bankruptcy court concluded that converting the case to one under Chapter 7 under § 1112(b) was the more appropriate remedy because the Chapter 11 estate was insolvent with no projected income and maintaining the case in Chapter 11 would result in further diminution of the estate.

On appeal the Bartmanns argue that there was no cause to convert their case under § 1112(b) because the thrust of CFS's Motion and evidence was that a Chapter 11 trustee should be appointed pursuant to § 1104. With this argument they appear to be contending that only the appointment of a trustee and not conversion was properly before the bankruptcy court. While § 1112(b) appears to prohibit a bankruptcy court from sua sponte converting a case by requiring that the issue be raised "on request of a party in interest or the United States trustee or bankruptcy administrator," we need not address that issue today. The Motion made by CFS requests the appointment of a trustee or in the alternative, conversion of the case. The remedy of converting the case under § 1112(b) was properly before the bankruptcy court. The remaining issue is whether the bankruptcy court abused its discretion when it converted the case under § 1112(b).

Section 1112(b) grants a bankruptcy court discretion to dismiss or convert a case for cause, whichever is in the best interest of creditors. 11 U.S.C. § 1112(b). Subsections (b)(1) through (10) lists factors that may indicate cause; however, this list is nonexhaustive. *Hall*, 887 F.2d at 1044.

The common theme of the ten examples is straightforward. In general, each example identifies a condition or set of circumstances that is typically sufficient to demonstrate that it is unlikely that the benefits of reorganization will be achieved within a reasonable amount of time and in a manner that is consistent with the requirements and restrictions of the Code.

7 Collier on Bankruptcy ¶ 1112.04[5] (Lawrence P. King ed., 15th ed. rev. 2001). The Tenth Circuit has concluded that a bankruptcy court has broad discretion

under 1112(b) to convert or dismiss a case. *Hall*, 887 F.2d at 1044 (citing S. Rep. No. 989, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5903).

The bankruptcy court based its order converting this case on § 1112(b)(1), which provides that a bankruptcy court may convert a case when there is “continuing loss to or diminution of the estate and absence of reasonable likelihood of rehabilitation.” As explained in a leading bankruptcy treatise, § 1112(b)(1) has two components:

First, it tests whether, after the commencement of the case, the debtor continues to experience a negative cash flow, or, alternatively, declining asset values. Second it tests whether there is any reasonable likelihood that the debtor, or some other party, will be able to stem the debtor’s losses and place the debtor’s business enterprise back on a solid financial footing within a reasonable amount of time.

7 Collier on Bankruptcy ¶ 1112.04[5][a] (Lawrence P. King ed., 15th ed. rev. 2001). Under § 1112(b)(1), both tests must be satisfied to convert the case. *Id.* The burden of proof is on the moving party. *In re Woodbrook Assocs.*, 19 F.3d 312, 317 (7th Cir. 1994). Once cause is established by the moving party, the debtor must show that there exists a reasonable prospect of reorganization within a reasonable time. *Id.*

The Bartmanns argue that CFS did not show by a preponderance of the evidence that the estate has suffered a continuing diminution post-petition or that there is an absence of a reasonable likelihood of rehabilitation. They further contend that none of the other enumerated items in § 1112 can be established because they have not been given an opportunity to submit a plan. The Bartmanns’ arguments fail.

The bankruptcy court found that the evidence presented at the hearing indicated that maintaining the Bartmanns’ case in Chapter 11 would result in continuing diminution to the estate. The evidence found most significant by the bankruptcy court was that several unauthorized post-petition transfers had occurred and that neither Bartmann was employed nor had any prospect of future

employment. Concurrently, the Bartmanns forecasted personal expenditures of approximately \$32,000 over the following four months. The funds for these expenses were to be paid from the estate. Although the Bartmanns claim that this evidence does not demonstrate diminution to the estate, they did not present any case law or factual evidence to the bankruptcy court that would dispute the bankruptcy court's conclusions that the estate had and would continue to have a negative cash flow.³ In fact, the Bartmanns admit many of the bankruptcy court's factual findings, taking exception only to its conclusions. In our review of the record, we find nothing erroneous in the bankruptcy court's factual findings or conclusions.⁴

Next the Bartmanns argue that the bankruptcy court erred when it found that there was no prospect of future rehabilitation. While the initial burden was on CFS to introduce evidence that there was no reasonable prospect of rehabilitation, the burden shifted to the Bartmanns to refute such evidence once produced. The bankruptcy court found that the Bartmanns had not presented any evidence that there would be any future income entering the estate and therefore, no prospect of rehabilitation within a reasonable time. The Bartmanns argue that the bankruptcy court erred in this finding.

Initially the Bartmanns argue that the bankruptcy court erred when it examined the circumstances as they existed at the time of the hearing. They

³ The Bartmanns refer to two cases in their briefs, *Hall v. Vance*, 887 F.2d 1041 (10th Cir. 1989), and *Oklahoma Refining Co. v. Blaik (In re Oklahoma Refining Co.)*, 838 F.2d 1133 (10th Cir. 1988). The Bartmanns allege that the bankruptcy court misrepresented the law and facts in these two cases in its oral ruling. We find no evidence in the record of such misrepresentation.

⁴ Additionally, we note that some of the bankruptcy court's findings not relating to § 1112(b)(1) would alone be enough to convert the Bartmanns' case. For example, a debtor's failure to follow court orders has been found to be enough to convert or dismiss a case. See *In re NuGelt, Inc.*, 142 B.R. 661, 667 (Bankr. D. Del. 1992) (“[I]ntentional violations of an order of this court constitutes cause under section 1112(b)”).

contend that the bankruptcy court should have surmised, based on William's previous employment history, that he could and would work again. This argument fails. At the time of the hearing, William had not worked during the previous two years and the Bartmanns presented no evidence of any future employment opportunities. Additionally, at that time, it was possible that William would not have been successful in the pending criminal proceeding and thus, prevented from finding viable employment. More important, pursuant to § 541, all property of the estate is determined as of the time of the bankruptcy filing. 11 U.S.C. § 541. In a Chapter 11 case, post-petition wages do not become property of the estate. 11 U.S.C. § 541(a)(6); *see also Toibb v. Radloff*, 501 U.S. 157, 166 (1991) (holding that "Congress' concern about imposing involuntary servitude on a Chapter 13 debtor is not relevant to a Chapter 11 reorganization" because Chapter 11 does not have a provision incorporating a debtor's future earnings). Yet the Bartmanns proposed a plan which would have used property of the estate to fund their personal expenses without any corresponding plan to compensate the estate for these expenses.

Next, the Bartmanns claim that there is now a realistic hope of rehabilitation because William can now work. Specifically, the Bartmanns contend that many of the bankruptcy court's findings are now moot because William was acquitted of the criminal charges that were pending during the bankruptcy hearing so today he can work and earn income for the estate. The Bartmanns misunderstand this Court's role in the appellate process. We are limited in our review to evidence available to the bankruptcy court at the time of trial. Evidence not presented at trial, not even existing during trial, is not relevant here.⁵

⁵ Similarly, we observe that while the Bartmanns ask this Court to take notice of alleged bias on the part of the bankruptcy court because of a ruling in
(continued...)

We further observe that if circumstances have now changed, the Bartmanns are not without remedy. Section 706(b) of the Bankruptcy Code provides that “[o]n request of a party in interest and after notice and a hearing, the court may convert a case under this chapter to a case under Chapter 11 of this title at any time.” 11 U.S.C. § 706(b). If the Bartmanns can now propose a viable plan, they may file such a motion, setting forth, as grounds, the basis for such a plan.

The Bartmanns next argue that the order should be overturned because they never had a chance to submit a plan. This argument fails. As the Seventh Circuit has explained:

A Chapter 11 case can be dismissed at any time. Creditors need not wait until a debtor proposes a plan or until the debtor’s exclusive right to file a plan has expired. Creditors, likewise, need not incur the added time and expense of a confirmation hearing on a plan they believe cannot be effectuated. The very purpose of § 1112(b) is to cut short this plan and confirmation process where it is pointless.

Woodbrook Assocs., 19 F.3d at 317 (citations omitted). Here, the bankruptcy court determined that a Chapter 11 plan could not be effectuated because there was continuing diminution to the estate with no hope of rehabilitation.

Finally, the Bartmanns claim that the bankruptcy court abused its discretion by converting the case under § 1112(b)(1) rather than appointing a Chapter 11 trustee under § 1104. After determining that the estate was administratively insolvent without any assurance of income, the bankruptcy court found that if it appointed a Chapter 11 trustee and the case was later converted, the delay in payment to the Chapter 11 trustee who could not be paid for services until all Chapter 7 administrative expenses were paid pursuant to § 726(b) would be “grossly unfair.” Transcript of Ruling, *in Appellee’s Supp. App.*, Vol I at 300. The bankruptcy court concluded that maintaining the case in Chapter 11 would

⁵ (...continued)
another matter, this issue is not properly before us. For the same reason, we decline to address CFS’s request for sanctions based on what it terms the Bartmanns’ disrespectful allegations.

only result in further diminution of the estate, and in the absence of any evidence of a reasonable likelihood of rehabilitation, conversion was in the best interest of the creditors. The Bartmanns have not indicated any evidence in the record that these findings were in error. We are convinced that the bankruptcy court acted well within its broad discretion when, pursuant to § 1112(b)(1), it converted the Bartmanns' Chapter 11 case to one under Chapter 7.

V. Conclusion

For the reasons set forth above, the bankruptcy court's order is
AFFIRMED.